APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 12,977

R. H. JOHNSON & CO., a Partnership, et al., *Petitioners*

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent*

Petition for Review of Order of
Securities and Exchange Commission

Opinion

Decided April 5, 1956

Mr. Milton S. Gould, one of the bar of the Court of Appeals of New York, *pro hac vice*, by special leave of Court, for petitioners. Mr. James R. Browning was on the brief for petitioners.

Mr. Arden L. Andresen, Special Counsel, Securities and Exchange Commission, with whom Messrs. William H. Timbers, General Counsel, Securities and Exchange Commission, Thomas G. Meeker, Associate General Counsel, Securities and Exchange Commission, and Ellwood L. Englander, Attorney, Securities and Exchange Commission, were on the brief, for respondent.

Before Wilbur K. Miller, Bazelon and Bastian, Circuit Judges.

Per Curiam: The petitioners, R. H. Johnson & Company, a partnership, R. H. Johnson & Company, Inc., and Rupert H. Johnson, seek review of an order of the Securities and Exchange Commission, entered November 16, 1955, which revoked the registrations of the partnership and corporation as brokers and dealers, and found Rupert H. Johnson was a cause of the revocation. The petitioners were found to have wilfully violated §§ 10(b) and 15(c)(1) of the

Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78 o(c)(1).

The voluminous record made in an exhaustive hearing amply supports the Commission's order.

Affirmed.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

April Term, 1956

No. 12,977

R. H. JOHNSON & COMPANY, a Partnership, et al., *Petitioners*

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent*

On Petition for Review of Order of the Securities and Exchange Commission.

Before: Wilbur K. Miller, Bazelon and Bastian, Circuit Judges.

Judgment

This cause came on to be heard on the record from the Securities and Exchange Commission, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is ordered and adjudged by this Court that the order of the said Securities and Exchange Commission on review in this cause be, and it is hereby, affirmed.

Dated: April 5, 1956.

Per Curiam.

JUL 17 1956

Clerk

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 174

RUPERT H. JOHNSON, R. H. JOHNSON & CO., and R. H. JOHNSON & CO., INC., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINION BELOW

The *per curiam* opinion of the Court of Appeals for the District of Columbia Circuit (Pet. App. 1a-2a) is reported at 231 F. 2d 523. The findings and opinion of the Securities and Exchange Commission appear at pp. 1209 *et seq.* of the Joint Appendix filed in the court below.

JURISDICTION

The judgment of the Court of Appeals was entered on April 5, 1956 (Pet. App. 2a). The petition for a writ of certiorari was filed on June 18, 1956. Peti-

tioners invoke the jurisdiction of this Court under 28 U. S. C. §1254(1).

STATUTES INVOLVED

The statutes involved are the Securities Act of 1933, Section 17(a), 15 U.S.C. 77q(a); the Securities Exchange Act of 1934, Sections 10, 15(b) and 25(a), 15 U.S.C. 78j, 78o(b) and 78y(a); and the Administrative Procedure Act, Sections 7 and 10, 5 U.S.C. 1006 and 1009. Also included is Rule XII(e) of the Commission's Rules of Practice. These provisions are printed in the Appendix hereto, *infra*, pp. 13-22.

QUESTION PRESENTED

Where the Securities and Exchange Commission found on the record that broker-dealers had acted fraudulently toward their customers—a finding which the court below held was amply supported by the record and is not disputed here—did the Commission, in finding that revocation of their registration was in the public interest, err in taking account of prior official disciplinary actions against these broker-dealers, without having put these prior actions formally into the record of the proceedings.

STATEMENT

Petitioners seek review of a judgment of the Court of Appeals for the District of Columbia Circuit affirming an order of the Securities and Exchange Commission, dated November 16, 1955, which, pursuant to Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78o (b), revoked the registrations of R. H. Johnson & Co., a partnership and R. H. Johnson & Co., Inc., as brokers and dealers in securities and, pursuant to Section 15A(b)(4) of that Act, 15 U.S.C. 78o-3(b)(4),

found R. H. Johnson individually to be a cause of the revocation.

The Commission found that petitioners and their employees sought and obtained the trust and confidence of customers who were uninformed and inexperienced in securities matters, and effected transactions, sometimes without the knowledge of the customer, which were excessive in volume and frequency in view of the resources of the customers and the character of their accounts, in order to obtain for petitioners excessive profits and commissions.[1] The Commission also found that petitioners had obtained secret and unlawful profits in some of the transactions.[2] Petitioners do not here contest the findings of fraud.

Petitioners' statement (Pet. 4) that "[N]o individual guilt on the part of R. H. Johnson was found and no misconduct or participation in the misconduct of the four salesmen was charged against Johnson individually" does not accurately reflect the record. On the

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[1] For example, in the Eaves account, an elderly widow and her spinister daughter placed with petitioners for investment about $50,000. Over a six year period there were effected 644 transactions (346 purchases and 298 sales) totaling over $1,000,000. The securities acquired in 216 of the purchases were sold within six months. Eighty-one percent of the purchases were reversed within one year. Over 50% of the transactions involved purchases, sales, repurchases and resales of 55 securities. Twenty-three repurchases occurred within three months of the sale, and 42 others within six months. Some securities were repurchased up to eight times. In a number of instances the repurchase was at a higher price than the price at which it had been sold (Jt. App. 1151-1156). As a result, the net capital in the account decreased $24,384. Petitioners' commissions and profits in this account amounted to $24,299.

[2] For instance, in the Ferry account, many of the confirmations were stamped with a legend stating that 5% was the maximum gross profit on the transaction. In 91 of these transactions, the actual profits ranged from 7% to 59% (Jt. App. 1166-1169).

contrary, the record shows that Johnson recklessly disregarded the interests of his customers, that he ignored and circumvented the Rules of the National Association of Securities Dealers (NASD) established to prevent such occurrences, that he discharged the clerical help necessary to maintain the records set up by the office manager as the only way to exercise adequate control of the salesmen, and that he had specific notice of at least some of the irregularities in these particular accounts, but took the position that "activity in itself is not a deterrent" if the account showed a profit (Jt. App. 1000-3,4), as accounts generally do in a rapidly rising market such as existed during this period.

Having made its findings with respect to petitioners' fraud, the Commission then turned to the question of what action should be taken in the public interest. In considering that question, the Commission said:

> "This is not first time that disciplinary action has been taken against registrant. Registrant was expelled from membership in the NASD for inducing the excessive trading in the E account, and in our opinion sustaining the expulsion we cited previous sanctions imposed on registrant by the NASD and the New York Stock Exchange."

The statement in the earlier opinion of the Commission to which reference was made is as follows:[3]

> "This is not the first time that disciplinary action has been taken against applicant. The NASD has twice before imposed sanctions upon applicant. * * * In 1946 it fined applicant $1,000 and costs because a branch office charged excessive markups

[3] Securities Exchange Act Release No. 4694, page 8.

in twenty-five transactions. In 1948 it suspended applicant for a period of thirty days because another branch office, without authorization by the customer, transferred the customer's contract for the purchase of when-issued stock to its own account and retained the profit realized on the subsequent resale.[11]

[11] We note also that in 1939 the New York Stock Exchange, of which applicant was then a member, fined it for employing persons without obtaining the required approval of the Exchange. In 1940, Johnson, at the suggestion of the Exchange, sold his seat in order to avoid certain disciplinary proceedings based on certain omissions in his membership application and misconduct by salesmen. Johnson claimed the omissions were not wilful but admitted that he had been negligent in supervising the firm's salesmen."

Under all the circumstances the Commission found it necessary and appropriate in the public interest to enter the order of revocation.

No petition for rehearing was filed with the Commission. Counsel for petitioners requested the Commission to grant a stay to enable them to file an application with the Court of Appeals for a stay pending review and the Commission granted a stay for 10 days.[4]

On review, the Court of Appeals for the District of Columbia Circuit affirmed the Commission's order in a *per curiam* opinion stating: "The voluminous record made in an exhaustive hearing amply supports the Commission's order" (Pet. App. 1a-2a).

ARGUMENT

This petition represents an unsuccessful attempt to create a procedural flaw upon which to overturn a de-

[4] Securities Exchange Act Release No. 5258.

cision based upon a course of fraudulent dealings so flagrant that no effort is here made to controvert the facts and so palpable that the Court of Appeals limited its opinion affirming the Commission's order to a short *per curiam* statement. Contrary to petitioners' assertion, the decision below is correct and presents no conflict or inconsistency with the rulings of any other court. We submit therefore that there is no call for further review.

1. Petitioners ask this Court to send the case back to the Commission for a new hearing, to be followed, no doubt, by subsequent appeals, on the naked and sole contention that they were prejudiced by the Commission's reference in its opinion to prior violations (*supra*, pp. 4-5), without any suggestion as to how they were prejudiced or what evidence they could properly offer if a new hearing were ordered. At no time since the institution of these proceedings, either orally or in any document filed with the Commission, the Court of Appeals, or this Court, have petitioners challenged the accuracy of the Commission's recital of the record of prior disciplinary actions nor have they indicated what arguments, if any, they could have made if they had availed themselves of the opportunity afforded them to do so (see *infra*, pp. 7-9). The reasonable inference is that their present contention is a drily "technical" one, wholly devoid of actual impact upon the substantive merits or propriety of the order of revocation. See Section 10(e) of the Administrative Procedure Act on the "rule of prejudicial error," App., *infra*, p. 22.

2. But petitioners' point does not even have a good "technical" basis. At an early point in the proceedings, the Commission upheld the objection of petition-

ers' counsel to evidence as to prior misconduct, which objection was made on the ground that the evidence was not material until there should be a finding of violation. In making his objection, petitioner's counsel stated: "let's get it very clear, he is a bad man anyway. He has had trouble before, but it doesn't belong here" (Jt. App. 891). However, the Commission necessarily would have to consider petitioners' prior conduct after it had determined that there were present violations. Past conduct and prior disciplinary actions are certainly material in the determination of the sanction to impose for new violations which have been found after a hearing.

This does not mean that the Commission then had to reopen the hearing, since it was content to rest upon matters as to which it could take official notice. That an administrative agency, in the course of the final decision, may take judicial notice (or official notice as it is termed in the Administrative Procedure Act) of facts outside the record is recognized by the Administrative Procedure Act. That Act, however, carefully safeguards such action and affords participants ample opportunity to controvert such noticed facts. Section 7(d) provides:

> "Where any agency decision rests on official notice of a material fact not appearing in the evidence in the record, any party shall on timely request be afforded an opportunity to show the contrary."[5]

[5] The Attorney General's Manual on the Administrative Procedure Act (1947) states at page 80:

> "* * * If official notice is taken of facts in the course of the final decision, the proceeding need not be reopened automatically, but the parties will be entitled to request reopening for the purpose of contesting the facts thus officially noticed by the agency."

Petitioners never made any "timely request" for "an opportunity to show the contrary" of the facts officially noticed, notwithstanding Rule XII(e) of the Commission's Rules of Practice, 17 C.F.R. 201.12(e), which provides for petitions for rehearing (App., *infra*, p. 22). In view of the fact that the Commission granted petitioners a stay of ten days within which to seek a judicial stay pending review in the Court of Appeals, petitioners may not now assume (Pet. 14) that the Commission would not have granted a stay pending consideration of a petition for rehearing before it.

It is beside the point (Pet. 14) that a petition for rehearing is not a mandatory prerequisite to an appeal. A party need not, as a prerequisite to appeal, request a rehearing to make the same contentions which have been fully explored during the proceedings. But if petitioners had any quarrel with the facts of which the Commission took official notice, they should have exhausted, at the administrative level, the remedy provided by the Administrative Procedure Act.[6] In this connection, it should also be noted that Section 25(a) of the Securities Exchange Act of 1934 provides, *inter alia*: "No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission." Cf.

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[6] "The cardinal principle of fair hearing is not that all facts must be in the record or that all facts must be subject to cross-examination but that parties must have a chance to meet in the appropriate fashion all materials considered. * * * The agencies should aggressively use all information they can reasonably bring to bear upon each case. So long as they give parties a chance to know the information and to meet it in the appropriate way their action will be well within the permissible limits marked out by Supreme Court decisions." Davis, *Administrative Law* (1951 edition), pp. 519, 520.

Federal Power Commission v. *Colorado Interstate Gas Co.*, 348 U. S. 492.[7]

3. The character of the matters as to which the Commission took official notice is also highly significant. In the prior proceeding against the same petitioners, the factual issue of their earlier misconduct was fully explored and the Commission's findings as to prior misconduct were based on evidence formally introduced in the hearings and which petitioners had full opportunity to controvert if they could do so. This factual determination was relevant to the question of sanction in both proceedings, and the standard, that of public interest, was identical. That determination as to petitioners' prior misconduct was reviewed by the Court of Appeals for the Second Circuit which held that "the Commission properly considered previous disciplinary action taken against the firm by the association and by the New York Stock Exchange." *Johnson, et al.* v. *Securities and Exchange Commission*, 198 F. 2d 690, 697, certiorari denied, 344 U. S. 855.

4. Revocation of registration is intended to exclude from the securities industry persons or firms from whom investors might suffer harm. Despite petitioners' references to revocation as a "penalty" or "punishment" (Pet. 5, 8, 11), it seems clear that protection of the public interest and not punishment is the object

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[7] *United States* v. *Bliss*, 172 U. S. 321 (Pet. 12) does not hold, as petitioner asserts, that the Commission could not take notice of an earlier decision as *res judicata* without "pleading" it. The case holds only that a party cannot insist on the benefit of *res judicata* unless he pleads or proves it. It would be strange indeed if an administrative agency, *sua sponte*, could not take notice of its own prior decision.

of Section 15(b).[8] But assuming, *arguendo,* that revocation is a penalty as petitioners contend, then, by analogy to criminal proceedings, all basis for their contention disappears. For in criminal proceedings the strict rules of evidence are limited to the primary question of violation, and do not extend to the problem of the sanction to be imposed. Courts have a wide discretion in using out-of-court sources of information to assist them in determining the extent of punishment to be imposed, including criminal records, affidavits, reports by probation officers, etc. *Williams* v. *New York*, 337 U. S. 241, 246-7.

5. The cases cited by petitioners in an attempt to create the appearance of conflict are in no way contrary to the decision below. The *Powhatan* case,[9] with which the petition claims a "direct conflict" (p. 9), turned on the use by the Government of tabulations compiled from secret data which were unavailable for proper cross-examination. There is no contention in the instant case that any of the facts referred to in the Commission's opinion were secret. On the contrary, as we have pointed out (*supra,* p. 9), they are matters of public record and were necessarily known to the petitioners.

The *Abilene* case[10] did not indicate that there was

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[8] The question of punishment is covered by Section 21(e) of the Act, 15 U.S.C., 78u(e), which authorizes the Commission to transmit evidence to the Attorney General for criminal prosecution. The fact that the Congress provided no alternative to outright revocation under Section 15(b) clearly demonstrates that the dominant purpose of the section is simply to protect investors rather than to punish violators.

[9] *Powhatan Mining Company* v. *Ickes*, 118 F. 2d 105 (C.A. 6).

[10] *United States* v. *Abilene and Southern Railway Co.*, 265 U. S. 274.

anything improper in the Interstate Commerce Commission's taking official notice of the items in tariffs and reports filed with it, but held that specific reference must be made to such data to preserve the rights of the parties. The *Ohio Telephone* case [11] was one in which the utility commission took notice of price trends in establishing rates. The thrust of the opinion was not that it was improper to take notice of these facts but that the utility commission had improperly refused to grant a rehearing to allow the company to contradict, explain, or rebut those facts. Similarly, in the *Morgan* case [12], where the Court held that the appellant had no opportunity "to know the claims of the opposing party and to meet them," the basic contention of the appellant which was sustained by the court was that its petition for a rehearing had been refused, and the case did not involve the problem of sanctions consequent upon proved violations.

Nothing in the opinions below indicates any disagreement with the principles set forth in these cases. The real issues in this case are basically factual ones and the proof of a fraudulent course of dealings was established to the satisfaction of the Commission and the Court of Appeals. There is no important question of law involved which requires review by this Court.

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[11] *Ohio Bell Telephone Co.* v. *Public Utilities Commission*, 301 U. S. 292.

[12] *Morgan* v. *United States*, 304 U. S. 1.

CONCLUSION

The decision below is correct. There is neither conflict nor need for further review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

SIMON E. SOBELOFF,
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JULY, 1956

APPENDIX

1. The Securities Act of 1933, 48 Stat. 74, provides in pertinent part:

* * * * *

SEC. 17 (a) [15 U.S.C. 77q(a)]. It shall be unlawful for any person in the sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

2. The Securities Exchange of 1934, 48 Stat. 881, provides in pertinent part:

* * * * *

SEC. 10 [15 U.S.C. 78j]. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations

as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may perscribe as necessary or appropriate in the public interest or for the protection of investors.

* * * * * *

SEC. 15 (b) [15 U.S.C. 78o(b)]. A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration, which shall contain such information in such detail as to such broker or dealer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, such broker or dealer, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine.

An application for registration of a broker or dealer to be formed or organized may be made by a broker or dealer to which the broker or dealer to be formed or organized is to be the successor. Such application shall contain such information in such detail as to the applicant and as to the successor and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the applicant or the successor, as the Commission may by rules and regulations require as necessary or appropriate in the

public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine. Such registration shall terminate on the forty-fifth day after the effective date thereof, unless prior thereto the successor shall, in accordance with such rules and regulations as the Commission may prescribe, adopt such application as it own.

If any amendment to any application for registration pursuant to this subsection is filed prior to the effective date thereof, such amendment shall be deemed to have been filed simultaneously with and as part of such application; except that the Commission may, if it appears necessary or appropriate in the public interest or for the protection of investors, defer the effective date of any such registration as thus amended until the thirtieth day after the filing of such amendment.

The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to or revoke the registration of any broker or dealer if it finds that such denial or revocation is in the public interest and that (1) such broker or dealer whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions) or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, (A) has willfully made or caused to be made in any application for registration pursuant to this subsection or in any document supplemental thereto or in any proceeding before the Commission with respect to registration pursuant to this subsection any statement which was at the time and in the light of the circum-

stances under which it was made false or misleading with respect to any material fact; or (B) has been convicted within ten years preceding the filing of any such application or at any time thereafter of any felony or misdemeanor involving the purchase or sale of any security or arising out of the conduct of the business of a broker or dealer; or (C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security; or (D) has willfully violated any provision of the Securities Act of 1933, or of this chapter, or of any rule or regulation thereunder. Pending final determination whether any such registration shall be denied, the Commission may by order postpone the effective date of such registration for a period not to exceed fifteen days, but if, after appropriate notice and opportunity for hearing, it shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors to postpone the effective date of such registration until final determination, the Commission shall so order. Pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, after appropriate notice and opportunity for hearing, such suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors. Any registered broker or dealer may, upon such terms and conditions as the Commission may deem necessary in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal with the Commission. If the Commission finds that any registered broker or dealer, or any broker or dealer for whom an application for registration is pending, is no longer in ex-

istence or has ceased to do business as a broker or dealer, the Commission shall by order cancel the registration or application of such broker or dealer.

* * * * *

SEC. 25 (a) [15 U.S.C. 78y(a)]. Any person aggrieved by an order issued by the Commission in a proceeding under this title to which such person is a party may obtain a review of such order in the Circuit Court of Appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the Court of Appeals of the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith served upon any member of the Commission, and thereupon the Commission shall certify and file in the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, and enforce or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may

seem proper. The Commission may modify its findings as to the facts, by reason of the additional evidence so taken, and it shall file such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, and enforcing or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).

3. The Administrative Procedure Act, 60 Stat. 237, provides in pertinent part:

* * * * *

SEC. 7. [5 U.S.C. 1006]. In hearings which section 4 or 5 requires to be conducted pursuant to this section—

(a) PRESIDING OFFICERS.—There shall preside at the taking of evidence (1) the agency; (2) one or more members of the body which comprises the agency, or (3) one or more examiners appointed as provided in this Act; but nothing in this Act shall be deemed to supersede the conduct of specified classes of proceedings in whole or part by or before boards or other officers specially provided for by or designated pursuant to statute. The functions of all presiding officers and of officers participating in decisions in conformity with section 8 shall be conducted in an impartial manner. Any such officer may at any time withdraw if he deems himself disqualified; and, upon the filing in good faith of a timely and sufficient affidavit of personal bias or disqualification of any such officer, the agency shall de-

termine the matter as a part of the record and decision in the case.

(b) HEARING POWERS.—Officers presiding at hearings shall have authority, subject to the published rules of the agency and within its powers, to (1) administer oaths and affirmations, (2) issue subpenas authorized by law, (3) rule upon offers of proof and receive relevant evidence, (4) take or cause depositions to be taken whenever the ends of justice would be served thereby, (5) regulate the course of the hearing, (6) hold conferences for the settlement or simplification of the issues by consent of the parties, (7) dispose of procedural requests or similar matters, (8) make decisions or recommend decisions in conformity with section 8, and (9) take any other action authorized by agency rule consistent with this Act.

(c) EVIDENCE.—Except as statutes otherwise provide, the proponent of a rule or order shall have the burden of proof. Any oral or documentary evidence may be received, but every agency shall as a matter of policy provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence and no sanction shall be imposed or rule or order be issued except upon consideration of the whole record or such portions thereof as may be cited by any party and as supported by and in accordance with the reliable, probative, and substantial evidence. Every party shall have the right to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts. In rule making or determining claims for money or benefits or applications for initial licenses any agency may, where the interest of any party will not be prejudiced thereby, adopt procedures for the submission of all or part of the evidence in written form.

(d) RECORD.—The transcript of testimony and exhibits, together with all papers and requests filed in the proceeding, shall constitute the exclusive record for decision in accordance with section 8 and, upon payment of lawfully prescribed costs, shall be made available to the parties. Where any agency decision rests on official notice of a material fact not appearing in the evidence in the record, any party shall on timely request be afforded an opportunity to show the contrary.

* * * * *

SEC. 10. [5 U.S.C. 1009]. Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion—

(a) RIGHT OF REVIEW.—Any person suffering legal wrong because of any agency action, or adversely affected or aggrieved by such action within the meaning of any relevant statute, shall be entitled to judicial review thereof.

(b) FORM AND VENUE OF ACTION.—The form of proceeding for judicial review shall be any special statutory review proceeding relevant to the subject matter in any court specified by statute or, in the absence or inadequacy thereof, any applicable form of legal action (including actions for declaratory judgments or writs of prohibitory or mandatory injunction or habeas corpus) in any court of competent jurisdiction. Agency action shall be subject to judicial review in civil or criminal proceedings for judicial enforcement except to the extent that prior, adequate, and exclusive opportunity for such review is provided by law.

(c) REVIEWABLE ACTS.—Every agency action made reviewable by statute and every final agency action for which there is no other adequate remedy in any court shall be subject to judicial review. Any preliminary,

procedural, or intermediate agency action or ruling not directly reviewable shall be subject to review upon the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final shall be final for the purposes of this subsection whether or not there has been presented or determined any application for a declaratory order, for any form of reconsideration, or (unless the agency otherwise requires by rule and provides that the action meanwhile shall be inoperative) for an appeal to superior agency authority.

(d) INTERIM RELIEF.—Pending judicial review any agency is authorized, where it finds that justice so requires, to postpone the effective date of any action taken by it. Upon such conditions as may be required and to the extent necessary to prevent irreparable injury, every reviewing court (including every court to which a case may be taken on appeal from or upon application for certiorari or other writ to a reviewing court) is authorized to issue all necessary and appropriate process to postpone the effective date of any agency action or to preserve status or rights pending conclusion of the review proceedings.

(e) SCOPE OF REVIEW.—So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4)

without observance of procedure required by law; (5) unsupported by substantial evidence in any case subject to the requirements of sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided by statute; or (6) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party, and due account shall be taken of the rule of prejudicial error.

4. Rule XII(e) of the Commission's Rules of Practice provides:

> (*e*) Any petition for rehearing by the Commission shall be filed within 5 days after issuance of the order complained of and shall clearly state the specific grounds and the specific matters upon which rehearing is sought.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 176

RUPERT H. JOHNSON, R. H. JOHNSON & CO. and R. H. JOHNSON & CO., INC., *Petitioners*,

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent*.

PETITIONERS' REPLY IN SUPPORT OF PETITION FOR CERTIORARI

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The Commission's Brief in Opposition admits that the finding of prior misconduct on which the SEC order in question was based was made without evidence in the record.

The only justification advanced by the Commission is (1) that petitioner should have objected by petition for rehearing before the Commission, and (2) that this failure of due process on the part of the Commission was a "technical" one. It is plain, however, that by making a final order effective immediately the Com-

mission denied petitioner the opportunity to petition for rehearing thereafter. It is equally plain that if any denial of due process may be said to be "technical", this one is not. For, at the hearing if one is granted, it will be shown by the documents themselves and by external evidence that the alleged prior proceedings are irrelevant to the issue of public interest on which the Commission gave them controlling weight. Unless we are to assume the Commission will disregard the evidence which would be presented to it, there is no basis for the assumption that it will come to the same conclusion when the factual basis on which it acted is established to be non-existent.

1. We repeat that it is conceded by the Government that no evidence whatever was before the Commission of the alleged prior proceedings on which the Commission relied in its opinion. It is conceded that petitioners were entitled to an opportunity to object and present evidence. The only justification now advanced is that petitioners could have and should have objected to the Commission's opinion by a petition for rehearing before the Commission in accordance with a general rule of the Commission providing a five day period in which petitions for rehearing may be filed.[1]

Of course, if petitioners had a real opportunity to complain on petition for rehearing, they should have done so. But the Commission issued an order effective at once and thus deprived petitioners of any opportunity whatsoever to petition for rehearing.

[1] Before the Court of Appeals, the Commission's principal defense was that the alleged prior proceedings, no evidence of which appeared in the record, constituted res judicata. This argument apparently has been abandoned before this Court, for no mention of it appears in the Brief in Opposition.

The petitioner R. H. Johnson & Co. was a securities brokerage firm which had been in existence in that form for almost thirty years. It had a large organization with a great many salesmen and thousands of active customer accounts. It had done business in twelve states without criticism from any of them. Yet, on November 16, 1955, the Commission *with immediate effect* revoked the right of the petitioner to do business. In other words, on that day, unless a stay of the Commission's order was obtained, a thirty year old business was required to close its doors.

Under these circumstances, it is surprising for the Commission to suggest that petitioner was under an obligation to file a petition for rehearing before the Commission. Plainly, the fact that the Commission made its order effective immediately required immediate recourse to the courts to prevent the closing of petitioners' doors.

It seems to us elementary that if the Commission intends to assert a right to have objections presented to it by petitions for rehearing it must withhold its sanction to permit persons subject to its orders to avail themselves of that right without surrendering valuable property rights in the interim. See *United States* v. *Abilene & S. Ry. Co.*, 265 U.S. 274, 281, where the Court stated: "In this case, the order, by its terms, was not to become effective until 37 days after its entry. There was, consequently, ample time within which to apply for a rehearing and a stay, before the plaintiffs could have been injured by the order." 265 U.S. at 281.

Indeed this appears to be implicitly conceded by the suggestion of the Commission (Opp. Br. p. 9) that

petitioner might have asked for a stay of the order pending consideration of a petition for rehearing. The Commission does not and cannot say it would have granted such a stay. It appears in the record that on November 17, 1955, petitioners by telegram requested a ten-day stay "to take necessary steps in appeal procedure or *alternatively determine course of action* . . . " (R. 1273). The requested stay was *not* granted. Instead a ten-day stay was issued later the same day only after recourse to the Court of Appeals and the setting of the date by that Court for argument on a motion for stay (R. 1275).

But assuming, contrary to every indication, that a stay for the purpose of filing a petition for rehearing might have been forthcoming, that possibility is no substitute for a right to present evidence. The Due Process Clause and the Administrative Procedure Act (Section 7(d)) require that petitioner be given an absolute right to challenge the taking of notice of "facts". Section 7(d) says parties "shall" have a right to contest "facts" officially noticed. Those requirements are not satisfied if they are conditioned upon the discretionary grant by the Government of the right to continue to do business on application and as a matter of grace. See *Prendergast* v. *New York Telephone Co.*, 262 U.S. 43, 48, where the Court, after noting that a petition for rehearing did not stay the effectiveness of the order in question, stated: "As the law does not require an application for a rehearing to be made and its granting is entirely within the discretion of the Commission, we see no reason for requiring it to be made as a condition precedent to the bringing of a suit to enjoin the enforcement of the order"; *Levers* v. *Anderson*, 326 U.S. 219.

Here the Commission issued its order with immediate effect. It did not withhold its sanction to give an opportunity to protest. It spoke its final word. By so doing it subjected its order and decision to review by appellate courts with all its infirmities. It cannot complain that these infirmities were not pointed out to it before its order became final, because it gave no opportunity to petitioners to do so.

2. The Government also contends that the respondent's position is "technical". We do not know by what standards it can be assumed that any failure of due process is "technical". But in this case the importance of that failure is obvious. As its opinion shows, the only consideration the Commission gave to the question of public interest was on the basis of the alleged prior proceedings. Petitioners were given no opportunity to establish that these prior proceedings were irrelevant, to explain them in their setting, to present evidence as to the nature of the transactions in question and to show that they had absolutely no relation to the public interest. For example, (a) the major reliance of the Commission in this respect is on a previous NASD proceeding. That proceeding is inadmissible and irrelevant. It dealt with certain transactions with two ladies named Eaves by one of petitioner's salesmen. Those very transactions were testified to at length in the present proceedings (JA 371-457, 921-961) and discussed in detail in the Commission's opinion (JA 1214-1216, 1230). The fact that the NASD had previously come to an unfavorable view of the identical transactions can have no conceivable impact on the public interest.

Thus, the principal proceeding mentioned in the text of the Commission's opinion was entirely irrele-

vant to the issue. Other proceedings are mentioned in the SEC opinion only in a subordinate way and are subject to different infirmities. Insofar as the New York Stock Exchange "sanctions" are concerned, they relate to alleged non-compliance with rules of the New York Stock Exchange designed to assure the monopoly control of its membership, and having no relation to investor protection, which is the sole problem of concern to the Commission in its determination of public interest in this proceeding.[2] Concerning earlier NASD proceedings mentioned, had the facts been permitted to be presented as they will be if this Court reverses this case, they would establish that the transactions questioned were either thoroughly proper or of no relevance whatsoever to any interest in the protection of investors.

The harsh penalty imposed by the Commission in the present case was justifiable and justified only on the assumption that the Commission was dealing with a confirmed violator of regulations imposed to protect the public. A hearing on the issue would establish that there was no basis for the assumption. The Commission would then be required to consider what if any sanction is appropriate on the basis of the transactions before it, and not on the basis of other transactions not before it. To predict, as the opposition brief does, that the Commission would come to the same conclusion when the basis for it has been removed is to attribute a degree of irresponsibility to the Commission which neither the petitioners nor this Court can accept.

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[2] This is in addition to the fact that the Exchange is a private membership body against whose actions in most instances no legal redress exists.

CONCLUSION

The violation of due process is conceded. The argument that petitioner had an obligation or indeed an opportunity to petition for rehearing is contrary to the fact. Remand will serve not only to vindicate due process but will require the commission on reconsideration to give proper weight to the evidence which would be presented to it. We are confident it would then refrain from imposing the drastic sanction here involved.

The papers before this Court show that the court below sanctioned such a clear violation by the SEC of the course of procedure required by repeated rulings of this Court, as to require the exercise of its supervisory power.

The petition for certiorari should be granted.

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August 31, 1956.